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Sankaty Advisors

March 5, 2010

Dear Sankaty Credit Opportunities III Investor,

We are pleased to report that COPs III returned 38.2% gross and 33.1% net of all fees and expenses in 2009. The NAV of the Fund has significantly improved off of its 2008 low to 0.72x net on an estimated basis. More importantly, relative to a year ago, we feel much more optimistic about the band of potential outcomes for the Fund given the stabilization of the economy and capital markets. COPs III remains on track to meet or exceed the models we presented at the Annual Meeting last May, and we continue to believe the Fund will return its original principal plus profits over the next few years.

**Market Review**

While the 2009 market rally was broad based, how and when one deployed capital made the difference between solid and spectacular returns. The credit markets stabilized in 2009, and after a tough first quarter, the leveraged loan and high yield bond asset classes posted record returns. The "bottoming" of the economy provided an important fundamental catalyst as it enabled the market to identify winners and losers. Market technicals were strong throughout the year as investors plowed into credit from other asset classes, coupled with limited net new supply. What new issuance there was almost exclusively refinanced and extended existing debt, thus no new net supply was created.

Positive catalysts for the market included limited new issuance, the emergence of bond-for-loan take-outs, and reduced default expectations as riskier borrowers secured amend-to-extend loans and covenant relief. The return of some liquidity to the market improved access to capital, which led to a moderation in the current default rate.

As we see it, the market and economic data remains paradoxical. While recent WSJ articles have reported small businesses declining at record pace, economists point to small businesses as the critical driver of economic growth and employment. On the consumer side, spending continues its steady recovery, up 3.5% over the last twelve months returning to peak 2008 levels. However, in February, consumer confidence dropped sharply to its lowest level since April 2009 (17th percentile over the last 43 years). Further compounding the ambiguity of the current economic backdrop, recent reports indicate stabilizing housing prices, while others show new and existing home sales hitting all-time lows. On the macro side, markets continue to punish the Euro for the budget problems of some of its smallest economies, while they now favor the dollar in spite of the fact that some of the U.S.'s largest states face unprecedented budget shortfalls exacerbating record federal deficits.

What we do know is that these market dichotomies often lead to pockets of opportunity. In 2009, we found compelling investment opportunities created by a lack of DIP financing, a shortage of 2nd lien financing, and a general freeze on middle market lending. Current dislocations on which we are focused include European loan secondaries, private placements globally, traditional restructurings, and restructured equities. In short, anything not liquid and/or complicated commands a significant premium.

We have included in the appendix a slide pack that further elaborates our current view on the factors at work in the credit markets.

## Portfolio Review

We repositioned the portfolio significantly during the fourth quarter, selling over $300 million holdings in order to harvest gains and redeploy the proceeds into a number of new stressed and distressed names. In the automotive space, we rotated the Fund out of Ford, Allison Transmission, Visteon, and Accuride and deployed the capital into several new private transactions, as well as a few stressed and distressed, including Seven Media, Veyance and Champion Homes. Our financial services industry team leveraged the knowledge of Sankaty's restructuring and middle market groups to build a large position in CIT equity coming out of its bankruptcy. We added to our exposure in Dockwise, a leader in oceanic heavy equipment transportation, by participating in a private sale of public equity owned by the controlling shareholders. Dockwise is a classic example of a credit informed equity investment, as Sankaty has been one of Dockwise's largest lenders. We have underwritten both the CIT and Dockwise investments to a mid-twenties return target.

The table below highlights the Fund's 2009 outperformance of its liquid asset benchmarks in both loans and bonds as well as in both the U.S. and Europe.

| 2009 COPs III Liquid Credit Performance | | | | |
|---|---|---|---|---|
| | Loans | | Bonds | |
| **US** | **Returns** | **% Portfolio** | **Returns** | **% Portfolio** |
| Sankaty | 56.4% | 53.9% | 148.0% | 26.1% |
| Index | 51.6% | | 58.9% | |
| **Europe** | | | | |
| Sankaty | 53.8% | 14.4% | 125.1% | 5.5% |
| Index | 48.5% | | 67.4% | |
| **Total** | | | | |
| Sankaty | 55.9% | 68.4% | 144.0% | 31.6% |

In the structured portfolio, we had a significant realization in our Winter Harbor equity investment in the fourth quarter. In just over a year, we generated a 1.7x multiple of money on the investment. The marks on the remainder of our illiquid structured assets continued to

improve in the fourth quarter. Some of these gains can be attributed to lower default rates, as JP Morgan revised its 2010 default projections even lower than previously forecasted to 2%, down from 4%. With default expectations decreasing, we are more optimistic than in the past year that the valuations of the Fund's structured investments will continue to improve.

In our middle market portfolio, company performance has stabilized and our confidence in earnings forecasts has increased considerably. Cost cuts have produced higher than expected EBITDA levels given the sales declines we witnessed in 2009. Some of our early cyclical investments are starting to see a rebound in demand, while our consumer-facing businesses are still awaiting a recovery. Importantly, most of our companies are expecting improved results in 2010.

We are currently seeing a significant premium on less liquid and private opportunities. COPs III has been active in this space, underwriting six new middle market transactions across three strategies. A recent example is Sankaty helping finance the Princeton Review's purchase of Penn Foster. Additionally, COPs III participated in two rescue financings of retailers with strong collateral coverage looking for short-term liquidity to support restructuring initiatives. Lastly, we purchased the senior and subordinated notes in Rug Doctor from a BDC that needed to sell assets and reduce its leverage. The senior debt is less than 2x levered at a 15% IRR with the senior mezzanine at 19-20% IRR. The Rug Doctor is a well-run business that we have followed closely for years and unsuccessfully bid to finance in the past.

**Outlook**

We believe that 2010 will be a classic credit pickers market. While the economy appears to have bottomed, the recovery will take some time, which should result in greater dispersion among the performance of companies with levered capital structures. Middle market and main street lending are still heavily constrained and present a significant opportunity. Given the number of industries and individual credits that we closely monitor, as well as the wide net that we cast through our middle market, restructuring, and industry teams, we feel we are uniquely positioned to source, diligence, and invest in a variety of opportunities across the credit spectrum that will continue to generate attractive risk-adjusted returns for the Fund.

Attached is a snapshot of the current portfolio and our positioning. As always, we are available to discuss any of this information or answer any questions you may have. Please feel free to contact Kyle Betty (kbetty@sankaty.com) or Jeff Hawkins (jhawkins@sankaty.com) directly.

Sincerely,

Sankaty Advisors

**SANKATY CREDIT OPPORTUNITIES III, L.P.**
**STATISTICAL SUMMARY**
**(as of December 31, 2009)**

## STATISTICAL ANALYSIS* (1,2)

| | Q409 Gross Return | Q409 Net Return | 2009 Gross Return | 2009 Net Return | Annualized ITD Net Return | Sharpe Ratio |
|---|---|---|---|---|---|---|
| Sankaty Credit Ops III | 10.9% | 10.6% | 38.2% | 33.1% | -11.4% | -0.3 |
| S&P 500 (w/ dividends) | 6.0% | 6.6% | 26.5% | 26.5% | -5.5% | -0.3 |
| JPM HY Index | 6.3% | 6.3% | 58.9% | 56.9% | 5.6% | 6.3 |
| LSTA Loan Index | 3.8% | 3.8% | 51.6% | 51.6% | 2.7% | 6.1 |

* Net returns are net of all fees, expenses and carry.

## TOP ISSUERS [3]

**Top 10 Issuers (excluding Mezz & Structured)**

| Issuer | Fund Net Equity % |
|---|---|
| Weather Channel | 2.2% |
| Goodyear Engineered Products | 1.7% |
| Aeroflex | 1.6% |
| ServiceMaster | 1.4% |
| LLOG Exploration Company, L.L.C. | 1.2% |
| Dockwise | 1.2% |
| Camaiee | 1.2% |
| Kabel Deutschland | 1.1% |
| CIT Group Inc. | 1.1% |
| Frontier Drilling | 1.1% |

**Top 5 Mezzanine Issuers**

| Issuer | Fund Net Equity % |
|---|---|
| Hamilton Steel Bar | 2.8% |
| BP Metals | 1.9% |
| United Diamond, LP (Ulterra) | 1.9% |
| Publishing Group of America | 1.9% |
| Charter Brokerage | 1.9% |

**Top 5 Structured Issuers**

| Issuer | Fund Net Equity % |
|---|---|
| Sankaty Special Situations | 4.3% |
| Beach Street V | 1.6% |
| Race Point IV CLO | 0.8% |
| Thomas Point II 0-10% | 0.8% |
| SSS Funding II LLC | 0.4% |

## FUND NET EQUITY ($m)

| | 09/30/09 | Profits | Net Contributions/ (Distributions) | 12/31/09 |
|---|---|---|---|---|
| Partners' Capital | $1,410.5 | $142.0 | $0.0 | $1,552.5 |

## BALANCE SHEET (MV in $m)

| | Long (A) | Short (B) | Net (A)-(B) | Gross (A)+(B) |
|---|---|---|---|---|
| Cash | $163.0 | $0.0 | $163.0 | $163.6 |
| Collateral (Restricted Cash) | 80.3 | 0.0 | 86.3 | 80.3 |
| | $243.3 | $0.0 | $243.3 | $243.3 |
| **By Asset Class** | | | | |
| Loans | $436.2 | $6.0 | $430.2 | $430.2 |
| Bonds | $206.5 | $6.0 | $206.5 | $266.5 |
| CDS/LCDS[3] | $16.7 | $36.6 | -$13.9 | $47.3 |
| Mezzanine (Private Debt) | $543.7 | $0.0 | $543.7 | $543.7 |
| Mortgage Backed Security | $2.6 | $0.0 | $2.6 | $2.6 |
| Equity (Public & Private) | $56.2 | $0.0 | $56.2 | $56.2 |
| Structured[3] | $177.2 | $0.0 | $177.2 | $177.2 |
| | $1,433.1 | $30.6 | $1,462.5 | $1,463.7 |
| **By Region** | | | | |
| North America | $1,190.8 | $1.9 | $1,188.9 | $1,192.7 |
| Europe | $229.2 | $28.7 | $200.5 | $257.9 |
| Other | $13.1 | $0.0 | $13.1 | $13.1 |
| | $1,433.1 | $36.6 | $1,462.5 | $1,463.7 |
| **By Industry** | | | | |
| Non-Industry Specific | $178.3 | $0.0 | $178.3 | $178.3 |
| Oil and Gas | $126.3 | $0.6 | $126.3 | $126.3 |
| Business Equipment and Services | $90.2 | $0.0 | $96.2 | $90.2 |
| Retailors (other than food/drug) | $88.6 | $0.6 | $88.6 | $88.6 |
| Automotive | $100.9 | $26.7 | $72.2 | $129.6 |
| Publishing | $66.0 | $0.0 | $66.6 | $66.0 |
| Cable Television | $62.0 | $0.0 | $62.0 | $62.0 |
| Electronic/Electric | $56.5 | $0.0 | $56.5 | $56.5 |
| Conglomerates | $53.6 | $0.0 | $53.8 | $53.8 |
| Food Services | $48.4 | $0.0 | $48.4 | $48.4 |
| Other | $562.1 | $1.9 | $566.2 | $564.6 |
| | $1,433.1 | $30.6 | $1,402.5 | $1,463.7 |
| Exposure (% of Equity)** | 92.3% | 2.6% | 90.3% | 94.3% |

**Exposure % is based off of total assets excluding cash

[1] Portfolio returns are computed based on the change in value during the period of a theoretical investment made at the beginning of the period. The change in value of a theoretical investment is measured by comparing the aggregate ending value of Limited Partners with the aggregate beginning value adjusted for cash flows related to capital contributions or withdrawals during the period. Returns are geometrically linked on a monthly basis. Investment performance results depict the return of the Limited Partners of the Partnership as a whole. Investment performance reflects the reinvestment of profits, dividends and income. Net returns are stated net of all fees, expenses and carry (see footnote 2). Returns are estimated as of December 31, 2009 and are stated before the finalization of annual financial statements. As with all unaudited estimates, these estimates are subject to uncertainties and variations and may not be predictive of final results once audited. Actual outcomes and results may differ materially from the returns indicated herein.

[2] Generally, the General Partner is entitled at year-end to a carry allocation equal to 20% of Net Profits for such fiscal year as discussed in the Limited Partnership Agreement. For purposes of presentation herein, the carry allocation has been included as a periodic expense and has been calculated on the Net Profits for the period. The Management Fee is a quarterly fee paid to Sankaty Advisors, LLC generally equal to 2% of each Limited Partner's capital account at the beginning of each quarter.

[3] Single name CDS/LCDS, Index CDX/LCDX, Tranche CDX/LCDX and Structured CDS included at maximum loss amount.

**There can be no assurance that the historical investment performance of the partnership is indicative of the performance which will be achieved by the partnership in the future. The discussion herein is a summary and qualified in its entirety by the Partnership's Limited Partnership Agreement, the Partnership's Confidential Offering Memorandum and the Form ADV of Sankaty Advisors, LLC. This letter is not an offering of securities for sale in any jurisdiction. Any indication of interest from prospective investors in response to this letter involves no obligation or commitment of any kind.**